

TAX·FEATURES

Spending Power Drops \$1,333 In Wake of Decade's Taxes, Inflation

The prototypical U.S. family is \$1,333 poorer than it was ten years ago, according to new analysis by Tax Foundation economists. Direct Federal taxes and inflation have eroded the family's spendable income by a full 13 percent, measured in constant 1973 dollars, they say.

From 1973 to 1983, before-tax income for this prototypical family (one earner employed full-time, year-round, with two dependent children) rose by \$12,205 in nominal dollars. This 103 percent boost over the last decade brought the median family's earnings from \$11,895 to \$24,100.

However, over the same period, Federal taxes rose 129 percent, from \$1,730 to \$3,955, a jump of \$2,225. Income taxes climbed a hefty 113 percent, increasing from \$1,098 to \$2,340. Social security taxes soared 156 percent, from \$632 to \$1,615, as ever more revenues were needed to pay for higher benefits and indexing of those benefits in an inflating economy.

While direct Federal taxes cut the family's current dollar gain by \$2,225, its nominal gain was still \$9,980 or 98 percent in the decade.

On top of this, the Consumer Price Index (CPI) more than doubled during the decade, bringing the purchasing power of each dollar down to 44 cents as compared to the 1973 dollar. All together, the family's after-tax real income was reduced by 13 percent.

Real purchasing power declined every year from 1976 to 1981, say Tax Foundation analysts. It edged up fractionally in 1982 and 1983. The purchasing power of this family, it is estimated, will be about 2 percent higher this year than it was in 1981. The gain reflects both the tax cuts in the Economic Recovery Tax Act of 1981 (ERTA) and the sharp drop in inflation over the last two years, according to the Tax Foundation.

Direct Federal taxes as a percent of income for the family reached the highest point in 1981, when taxes claimed 17.2 percent of income. In 1983, this tax bite is estimated at 16.4 percent of income.

The accompanying table gives details for the decade 1973-1983.

\$1.5 Billion Price Tag For U.S. Congress in 1983— Up 15 Percent Over 1982

Congress will spend \$1.5 billion on itself in fiscal year 1983, Tax Foundation analysts report, based on current Budget estimates. That is a 15 percent (\$201 million) increase over what Congress cost taxpayers last year. The 1984 Budget presented in January of this year reports the estimated cost of Congress in 1983 at \$1,527.1 million, compared with actual spending of \$1,362.5 million in fiscal year 1982, say Foundation economists.

Costs of the Legislative Branch are mushrooming. The 1983 estimate comes to more than twice the \$726.2 million in spending recorded for Congress as recently as 1975. It was in 1976 that Tax Foundation first

(Continued on page 2)

THIS ISSUE:

PAGE 1:
Family Incomes;
Cost of Congress

PAGE 3:
U.S. Debt;
Health/Housing
Subsidies

PAGE 4:
Taxes on Top
Earners

Median Family Incomes Before and After
Direct Federal Taxes and Inflation
1973-1983

Year	Median family income ^a	Direct Federal taxes			After-tax income	
		Income tax ^b	Social security	Total	Current dollars	1973 dollars ^c
1973	\$11,895	\$1,098	\$ 632	\$1,730	\$10,165	\$10,165
1974	13,004	1,267	761	2,028	10,976	9,888
1975	14,156	1,172	825	1,997	12,159	10,040
1976	15,016	1,388	878	2,266	12,750	9,953
1977	15,949	1,466	933	2,399	13,550	9,934
1978	17,318	1,717	1,048	2,765	14,553	9,918
1979	19,048	1,881	1,168	3,049	15,999	9,797
1980	20,586	2,143	1,262	3,405	17,181	9,267
1981	21,462 ^d	2,267	1,427	3,694	17,768	8,680
1982	22,900 ^d	2,338	1,534	3,872	19,028	8,761
1983	24,100 ^d	2,340	1,615	3,955	20,145	8,832

^aMedian income for all families with one earner employed full-time, year-round.

^bMarried couple filing joint return, two children.

^cAdjusted by Consumer Price Index of the Bureau of Labor Statistics.

^dEstimated by Tax Foundation.

Source: U.S. Department of Commerce, Bureau of Labor Statistics; Treasury Department, Internal Revenue Service; and Tax Foundation computations.



TAX FOUNDATION, INCORPORATED

1875 Connecticut Avenue, N.W., Washington, D.C. 20009

Federal Budget Outlays for the Legislative Branch by Unit
Selected Fiscal Years 1970-1983^a
 (Thousands)

Unit	1970	1975	1980	1982	1983
Total	\$343,147	\$726,191	\$1,217,985	\$1,362,490	\$1,527,055
Congress, total	179,159	326,214	581,543	693,593	733,812
Senate	57,585	102,237	183,890	213,229	247,070
House of Representatives	108,279	178,988	324,569	375,241	397,131
Joint activities	13,295	44,989	73,084	105,123	89,611
Legislative agencies, total	163,988	399,977	636,442	668,897	793,243
Architect of the Capitol	18,797	50,894	89,496	109,879	121,826
Botanic Garden	620	998	1,583	1,801	2,383
Congressional Budget Office	—	—	12,101	13,632	14,963
General Accounting Office	69,857	125,941	201,192	229,827	249,957
Government Printing Office	34,141	121,436	115,747	91,237	109,783
Library of Congress	49,804	100,795	192,740	209,374	277,882
Office of Technology Assessment	—	2,723	11,131	11,394	13,690
U.S. Tax Court	2,972	11,028	9,703	11,399	14,547
Other	—	—	13,675	716 ^b	1,028
Deductions for offsetting receipts	-12,203	-15,370	-10,926	-10,362	-12,816

^aData for 1983 are preliminary.

^bDecline from 1980 reflects primarily the phasing out of the Temporary Commission on Financial Oversight of the District of Columbia, for which fiscal 1980 outlays are \$11,622 thousand.

Source: Office of Management and Budget.

"Congress alone will cost the taxpayers \$734 million in fiscal 1983."

Now Available

- "Consumption Tax: An Idea Whose Time Is Coming," *Special Report*, April, 16 pp., \$5.00.
 - "U.S. Tax Treatment of Foreign Source Income," *Federal Tax Policy Memo*, 4 pp.
 - Fiscal Policy Forum*, "At Issue: The Balanced Budget Amendment," January, 6 pp.
 - Fiscal Policy Forum*, "At Issue: Productivity," April, 6 pp.
 - "Needed: More Fiscal Responsibility," by Maynard H. Waterfield, *Special Report*, January, 4 pp.
 - "The Reagan Budget: 1984-1988," by Elsie M. Watters, *Special Report*, March, 4 pp.
 - "The Federal Fiscal Dilemma: Is There a Solution?" *Proceedings of Tax Foundation's 34th National Tax Conference*, 1982, 28 pp., \$7.50.
 - "Unemployment Insurance: Trends and Issues," *Research Publication No. 35*, 96 pp., \$5.00.
- (Please include \$1.00 for postage and handling on all orders that are not prepaid.)

Monthly Tax Features

Monthly Tax Features is published by the Tax Foundation, Incorporated. Original material is not copyrighted and may be reproduced. Please credit Tax Foundation, Incorporated.

Chairman of the Board	W. Bruce Thomas
Executive Vice President	Robert C. Brown
Director of Research	Elsie M. Watters
Director of Federal Tax Policy	Douglas P. Bates
Editor	William J. Wilson
Publications Manager	Sarah G. Wise

Tax Foundation, Incorporated
 1875 Connecticut Avenue, N.W.
 Washington, D.C. 20009
 (202) 328-4500

(COST OF CONGRESS, from page 1)

addressed the issue of the cost of Congress, in "The Legislative Branch—The Next Billion Dollar Bureaucracy." The prediction became a reality in 1978 when Federal outlays for the Legislative Branch broke the \$1 billion mark for the first time. That year, the tab for the Senate, the House of Representatives, and related agencies cost taxpayers \$1.05 billion for the fiscal year.

In 1980 and 1981 the cost of Congress edged up to \$1.2 billion a year. Four months into fiscal 1982 the cost had been pegged at over \$1.5 billion for that year. Later figures released this year, however, indicate that the \$1.5 billion tab will not be reached until the current fiscal year, which ends September 30, 1983.

Congress alone will cost the taxpayers \$734 million in fiscal 1983—\$247 million for the Senate, \$397 million for the House of Representatives, and \$90 million for joint activities. Another \$793 million will be spent by various legislative agencies, up from \$669 million in 1982—a rise of nearly 19 percent.

The Library of Congress is budgeted to spend \$278 million in 1983, compared to \$209 million in 1982 (up 33 percent); the General Accounting Office, \$250 million, compared to \$230 million (up 9 percent); the Architect of the Capitol, \$122 million, compared to \$110 million (up 11 percent); and the Government Printing Office, \$110 million, compared to \$91 million (up 20 percent).

Not all areas are experiencing cost increases, however. Congressional spending in several categories has been reduced in recent years. From 1980 to 1981 Government Printing Office costs were cut by \$39 million, more than 33 percent, in the wake of sharp reductions in the number of government publications printed. Unfortunately for budget-watchers, however, rising costs in the last two years have now whittled the 1980-1983 reduction from this source down to a mere 5 percent. A more lasting saving resulted from the expiration of a Temporary Commission on Financial Oversight of the District of Columbia, which had cost taxpayers \$11.6 million in fiscal year 1980.

Even bigger reductions among single items lie ahead with the completion of construction on the new \$137 million Hart Senate Office Building. Construction of the building, spread over 10 years, had cost \$41.2 million in 1981. Outlays in 1983 are pegged at \$13.5 million, and 1984 costs will hit only \$2.9 million.

Although Budget documents do not provide separate data on Legislative salaries, this component makes up a substantial share of all costs of Congress. As of October 1982 (latest reported) there were 38,464 persons on the Legislative Branch payroll, including Members of Congress. Some 19,171 of the employees were assigned to Congress as distinct from legislative agencies.

The largest agency employers were the Government Printing Office (5,965 employees), the Library of Congress (5,245), and the General Accounting Office (5,212). Total employment in the Legislative Branch has been relatively stable in recent years at 38,000-39,000, but declined by 730 persons, or 2 percent, between October 1980 and October 1982. Since 1970, however, employment has risen by 25 percent.

The budget submitted in January of this year projects another \$56 million increase in outlays for the Legislative Branch in fiscal 1984.

The accompanying table provides further details.

U.S. Debt Grows \$1,000/Person/Year

The Federal government was able to live within its legal credit limits for the first eight months of its 1983 fiscal year, but not a moment longer. Testifying before Congress in May, Treasury officials said that the debt limit had to be raised immediately, because Federal debt would reach \$1.320 trillion by June 1, exceeding the \$1.290 trillion lid approved by Congress last fall.

At present rates, the Federal debt is increasing \$1,000 per year per person, Tax Foundation economists say.

A \$99 billion increase—to \$1.389 trillion—was approved in late May and signed by the President almost immediately. In raising the ceiling, Congress also decided that it was time to abandon the now mostly symbolic "permanent" debt limitation of \$400 billion that had been in effect since 1972. Since then, lawmakers have simply approved a "temporary additional" limitation on 22 separate occasions, each time lifting the "temporary" addition to a higher level.

(Continued on page 4)

Federal Deficits, Debt Outstanding, and Related Measures
Selected Fiscal Years 1975-1984^a
(Billions, except per capita)

Year	Receipts	Outlays ^b	Deficit ^b	Interest on the public debt	Debt outstanding ^c	
					Total	Per capita
1975	\$279.1	\$332.3	\$ -53.2	\$ 32.7	\$ 544.1	\$2,519
1976	298.1	371.8	-73.7	37.1	631.9	2,898
T.O. ^d	81.2	96.0	-14.7	8.1	646.4	2,957
1977	355.6	409.2	-53.6	41.9	709.1	3,222
1978	399.6	458.7	-59.2	48.7	780.4	3,496
1979	463.3	503.5	-40.2	59.8	833.8	3,693
1980	517.1	590.9	-73.8	74.8	914.3	4,005
1981	597.3	678.2	-80.9	95.5	1,003.9	4,355
1982	617.8	745.7	-127.9	117.2	1,147.0	4,929
1983	598.3	825.3	-227.0	126.8	1,392.0	5,929
1984	653.7	858.3	-204.7	143.1	1,622.6	6,849

^aData for 1983 and 1984 are based on estimates presented by the Administration in April 1983.

^bIncludes activities of off-budget agencies; no receipts are attributable to these transactions.

^cEnd of fiscal period.

^dTransition quarter.

Source: Office of Management and Budget, Department of Commerce, and Tax Foundation computations.

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"The Nose of the Camel"

There is a notion which has gained acceptance in Washington over the last 20 years that, because an idea is worthy and doable, it should be done and paid for by the public. On this questionable premise rests the vast social welfare apparatus now burdening the taxpayer.

Food stamps began in the Kennedy Administration as an experiment to improve child nutrition. The program has grown 1,000 percent, from \$13 million in fiscal year 1961 to \$12.5 billion in fiscal year 1983. What is more, the stamps are now viewed as a "social contract" item, routinely increased every year in step with population and the cost of living.

The same holds for medical aid. Welfare medical-care payments started small, totalling \$48 million in 1951. Medicaid for fiscal 1984 is budgeted at \$21 billion. Medicare benefits started at \$2.3 billion in fiscal 1967. Then—in 1967—it was estimated that Medicare would cost about \$6 billion by 1984. In actuality, the proposed 1984 Medicare budget is \$81 billion.

Newly arrived on the scene are proposals for health insurance and housing subsidies for the long-term unemployed. Both the House and the Senate have addressed each of these questions. Proposed spending levels range from \$5.4 billion in the House and \$1.8 billion in the Senate for health assistance, and \$760 million in the House and \$750 in the Senate for mortgage help to the long-term unemployed who face foreclosure.

Skip the details, because it is not a single bill or a particular method of providing such aid that is at question here. The issue is that we once again face well-

meaning programs, begun at small levels of spending, which will surely run amok, if past experience means anything.

Such programs are like the nose of the camel. Once the nose is in the tent, the whole camel soon follows. So too, once the policy option of helping unemp. yed persons cover health insurance costs and mortgage payments is enacted into law, the huge budgetary outlays will be impossible to stop.

If you have any doubts, look at food stamps and Medicaid/Medicare costs. Look at the \$200 billion deficits being projected for the next several years. Most of that shortfall can be traced to the unrestrained growth of social welfare programs as a percentage of the Federal budget over the last 20 years.

In short, beware the nose of the camel.

"The issue is that we once again face well-meaning programs, begun at small levels of spending, which will surely run amok, if past experience means anything."



Tax Foundation, Incorporated

"If the \$33.8 billion had simply been confiscated, Uncle Sam would have netted an additional \$12.7 billion, enough to run the Federal government for about 8 days."

(DEBT LIMIT, from page 3)

Without Congressional action the previous debt limit of \$1.290 trillion would have reverted to the \$400 billion permanent limit by September 30, 1983.

In asking for the increase, a Treasury spokesman told Congress that unless the ceiling were approved, the Administration would have to choose which of its bills to pay—social security, payroll, unemployment checks, or defense contracts—or "indeed, whether, for the first time in history, the United States will default on its obligations."

Based on current estimates by the Administration, the debt ceiling will have to rise by another \$230 billion or so—to more than \$1.6 trillion—by the end of the forthcoming fiscal year (September 30, 1984).

On a per capita basis, debt is projected at \$6,849 at that time, almost twice what it was as recently as 1978.

U.S. Could Run for 8 Days By Taxing Top Earners 100%

One of the unexploded myths of the U.S. progressive tax system is that high taxes on top earners generate significant amounts of revenue. Tax Foundation's on-going research into tax dollars brought in at various bracket rates continues to show that this is not so.

About 88 million Americans filed tax returns in 1980. Nearly 1.8 million showed income taxed at marginal rates above 50 percent, according to the latest data available from the U.S. Treasury. This represented 2.0 percent of returns filed.

These top payers had \$33.8 billion in taxable income subject to rates higher than 50 percent—2.7 percent of the total Federal income tax base. The Federal Treasury collected nearly two-thirds of that income—\$21.1 billion—from these taxpayers. It represented 8.3 percent of all 1980 Federal income tax revenues.

If the \$33.8 billion had simply been confiscated (taxed at 100 percent), Uncle Sam would have netted an additional \$12.7 billion, enough to run the Federal government for about 8 days.

The costs break down as follows: Federal spending—off-budget, as well as on-budget—came to \$590.9 billion in 1980. That's about \$1.6 billion a day.

In 1980, 468,000 returns fell into this category, with average income of \$51,250 and average taxes of \$25,620 per return. At that time, rates ranging from 54 to 70 percent were imposed on so-called "unearned" income only. Since 1972, "earned" income has been taxed at a top marginal rate of 50 percent.

In tax year 1980, rates above 50 percent were levied on income above \$41,500 for single taxpayers, above \$60,000 for married persons filing joint returns, above \$44,700 for heads of households, and above \$30,000 for married persons filing separate returns.

In 1981, Congress approved a reduction in the top rate applying to "unearned" income from 70 percent to 50 percent, effective in 1982.

The accompanying table gives details.

**Federal Individual Income Tax Generated at Each Tax Rate
Income Year 1980**

Tax rate ^a (percent)	Number of returns with any tax at rate ^b (thousands)	Tax base taxed at rate (millions)	Tax generated at rate (millions)	Percent of total		
				Returns	Tax base	Tax generated
Zero	88,105	234,840	\$ 0	100.00	18.47	.00
14	76,121	124,734	17,463	86.40	9.81	6.83
16	69,129	111,623	17,860	78.46	8.78	6.98
18	62,815	193,011	34,742	71.30	15.18	13.58
21	62,026	171,254	35,348	70.40	13.47	13.82
24	39,697	119,879	28,626	45.06	9.43	11.19
28	27,061	83,261	22,988	30.71	6.55	8.99
32	18,812	67,894	21,427	21.35	5.34	8.38
37	11,275	43,747	15,822	12.60	3.44	6.19
43	6,127	37,809	16,038	6.95	2.97	6.27
49	3,227	25,449	12,313	3.66	2.00	4.82
50	468	23,983	11,992	.53	1.89	4.69
54	767	9,120	4,925	.87	.72	1.93
59	497	5,706	3,300	.56	.45	1.29
64	295	5,830	3,717	.33	.46	1.45
68	118	2,818	1,916	.13	.22	.75
70	79	10,376	7,264	.09	.82	2.64
0-70	88,105	1,271,335	255,740	100.00	100.00	100.00

^aData for heads of households and unmarried individuals are combined with data in brackets for next higher rate.

^bMost returns have a tax base taxed at more than one rate. For example, a married couple's taxable income (adjusted gross income minus exemptions and itemized deductions in excess of \$3,400) of \$7,600 in 1980 was taxed as follows: first \$3,400 at zero rate (= \$0), next \$2,100 at 14% (= \$294), next \$2,100 at 16% (= \$336), and the total tax was \$630.

Source: Treasury Department and computations by Tax Foundation.



TAX FOUNDATION, INCORPORATED

1875 Connecticut Avenue, N.W., Washington, D.C. 20009

Non-Profit Org.
U.S. Postage
PAID
Washington, D.C.
Permit No. 1287

TAX·FEATURES

\$1.3 Trillion Spending in FY83 By All Levels of Government in U.S.

Federal, state, and local governments in the United States will spend an estimated \$1.3 trillion during the current fiscal year, according to Tax Foundation economists. This is \$103 billion (8.6 percent) more than they spent in fiscal year 1982.

The 1983 total breaks down to \$5,587 per U.S. resident, and to \$15,345 per household.

The Federal government will account for nearly two-thirds of the spending—\$864.8 billion, including grants-in-aid to states and localities. Subnational governments will spend the rest—an estimated \$435.5 billion from their own revenue sources. Federal outlays in 1983 are expected to grow by 10.1 percent, considerably above the 5.9 percent growth projected for state and local governments by analysts at the Tax Foundation.

Between 1950 and 1970, all government spending rose at an average annual rate of around 8 percent. Spending growth accelerated during the 1970s to 11.2 percent. In the first three years of the 1980s, increases have dropped back slightly to average 10.7 percent a year.

In the last seven years alone, total government spending has more than doubled, rising from \$625.1 billion in 1976 to an estimated \$1,300.3 billion in 1983. During the same period Federal spending has increased by 122 percent, and state and local spending, by 85 percent.

Ever since 1950, spending by governments has tended to outpace growth in the overall economy, as measured by Gross National Product (GNP). Government expenditures moved up from 21.3 percent of GNP in 1950, to 26.9 percent in 1960, 31.6 percent in 1970, and to 35.5 percent of GNP in calendar year 1982. Over the past 12 years state-local spending has declined slightly in relation to GNP, from 11.0 percent in 1970 to 10.5 percent in 1982. On the other hand, Federal spending has risen from 20.6 percent of GNP in 1970 to 25.0 percent in 1982, the latest year reported.

On a per capita basis, government expenditures will rise from \$2,886 in 1976 to an estimated \$5,587 in the current fiscal year, or by 94 percent. Because the number of households is growing faster than population generally, the rise for households will be somewhat less—79 percent, from \$8,579 in 1976 to \$15,345 during the current year.

Additional details on total spending by level of government, and per capita and per household data are shown in the table on page 4.

The other article on this page discusses changes in the composition of government spending since 1960.

Social Security Claims 16¢ of Each Dollar Spent By U.S. Governments

The Federal social security system became the most costly of all government programs in fiscal year 1981, the latest for which full data have been reported. Expenditures for the Old-Age, Survivors, Disability, and Health Insurance (OASDHI) program totaled \$177.5 billion, accounting for 16.0 cents out of every dollar spent by Federal, state, and local units, up from 7.1 cents in 1960, according to analysis by Tax Foundation economists.

Spending for national defense was the second largest budget item, accounting for 15.7 cents of the spending dollar in 1981, down from 32.3 cents in 1960 and 25.3 cents in 1970. Education was the third most costly government function, claiming 14.2 cents of every spending dollar in 1981, up from 12.8 cents in 1960 but

(Continued on page 2)

THIS ISSUE:

PAGE 1:
U.S. Spending;
Social Security

PAGE 2:
U.S. Revenues

PAGE 3:
FY84 Budget;
Tax Policy

PAGE 4:
Facts & Figures

INSERT:
Tax Laws

How Federal, State, and Local Governments Spend Each Dollar of Public Funds

Selected Fiscal Years 1960-1981

Function	Cents per dollar of total spending		
	1960	1970	1981
Social security programs (OASDHI)	7.1	10.8	16.0
National defense ^a	32.3	25.3	15.7
Education	12.8	16.7	14.2
Social services and income maintenance ^b	8.5	10.7	13.1
Interest on general debt	6.2	5.5	8.8
Environment and housing	5.4	4.4	5.2
Transportation	7.6	6.2	4.2
Utilities and liquor stores	3.4	2.8	3.9
Government employee retirement	1.4	1.9	3.0
Public safety	1.8	2.0	2.2
Government administration	1.8	1.9	2.0
Postal service (Federal)	2.5	2.3	1.8
Sanitation	1.1	1.0	1.3
All other	7.9	8.3	8.4
Exhibit (billions):			
Total spending	\$151.3	\$333.0	\$1,109.8

^aIncludes international relations.

^bIncludes public welfare (cash assistance to the needy and vendor payments under Medicaid), hospitals, health, and unemployment insurance benefits.

Source: *Facts and Figures on Government Finance*, 1983, Tax Foundation (forthcoming); basic data from U.S. Department of Commerce, Bureau of the Census.

Individual Income Taxes Top Revenue Raiser in U.S. —30.9¢ of Every \$1 Taken

"In fiscal 1981, income taxes provided 43 cents out of every dollar raised by the Federal government."

Individual income taxes have been the biggest single revenue provider for U.S. governments since 1944. Then they accounted for 30.9 cents of every dollar of revenue raised. Perhaps by coincidence, Tax Foundation researchers say, the share was exactly the same—30.9 cents—in fiscal year 1981, the latest for which full tax data for all units have been reported. In 1960, the contribution of income taxes was slightly lower—28.2 cents per revenue dollar. The Federal government, 40 states, the District of Columbia, and local governments in 11 states now impose a broad-based personal income tax. In fiscal 1981, income taxes provided 43 cents out of every dollar raised by the Federal government, 17 cents per dollar for the states, and about 3 cents for local units.

The second leading source of government revenues, and also the most rapidly rising, is the Federal social security tax, which finances the Old-Age, Survivors, Disability, and Health Insurance program. In 1981,

social security taxes brought in 15.2 cents of every dollar of revenue raised by all governments (24.8 cents per dollar of Federal revenues), in contrast to 7.0 cents per dollar in 1960.

The role of state and local general sales taxes also grew rapidly during the last two decades—from 3.5 cents per dollar of revenue for all governments in 1960 to 5.2 cents in 1981. The Federal government has never imposed a general sales tax, but the tax is an important source of revenue for 45 state governments, the District of Columbia, and for hundreds of local governments in over two dozen states. In 1981, general sales taxes provided 19 cents of each revenue dollar raised by the states and 5 cents of every local revenue dollar.

Sources of revenue with a declining role in the total revenue structure during the last two decades include corporation income taxes; selective sales taxes on such commodities as gasoline, tobacco, and alcohol; and property taxes.

Corporate income taxes furnished 14.8 cents per total revenue dollar in 1960 and only 7.0 cents in 1981. The role of selective sales taxes declined from 12.5 cents in 1960 to 7.3 cents per dollar of revenues raised by all governments in 1981. During the same period, the share of property taxes in the revenue dollar fell from 10.7 cents to 7.0 cents.

The drop in the significance of property taxes was not so pronounced for the total revenue structure, but was quite severe for local governments. In 1981 property taxes comprised 41 cents of every dollar raised by local units, down from 58 cents in 1960. Property taxes are not levied at all by the Federal government and are used only to a slight extent by the states, say Tax Foundation economists.

While taxes still account for the lion's share of public revenues, their contribution to the total revenue dollar dropped from 82.7 cents in 1960 to 77.6 cents in 1981. Nontax revenues—especially current charges and miscellaneous general revenues, including interest earnings of governments on their security holdings—rose from 17.3 cents per dollar of revenues raised in 1960 to 22.4 cents in 1981.

The accompanying table provides further details.

How Federal, State, and Local Governments Raise Each Dollar of Public Funds

Selected Fiscal Years 1960-1981

Source	Cents per dollar of total revenue		
	1960	1970	1981
Tax revenues	82.7	82.4	77.6
Property	10.7	7.3	7.0
Individual income	28.2	30.7	30.9
Corporate income	14.8	8.4	7.0
General sales	3.5	5.5	5.2
Selective sales and excises	12.5	6.5	7.3
Social security (OASDHI)	7.0	15.0	15.2
Other taxes ^a	6.0	9.0	5.0
Nontax revenues	17.3	21.8	22.4
Current charges	8.1	8.6	8.4
Miscellaneous general revenue ^b	3.3	6.7	7.4
Employee retirement	1.9	3.1	3.2
Utilities and liquor stores	3.2	2.7	2.8
Other nontaxes	.8	.7	.6

Exhibit (billions):			
Total revenues	\$153.1	\$333.8	\$1,075.4
Surplus (+) or deficit (-)	+\$ 1.8	+\$.8	-\$ 34.4

^aIncludes death and gift, motor vehicle and operators' license, unemployment compensation, and miscellaneous taxes.

^bIncludes interest earnings, special assessments, sale of property, and others.

Source: *Facts and Figures on Government Finance*, 1983, Tax Foundation (forthcoming); basic data from U.S. Department of Commerce, Bureau of the Census.

Monthly Tax Features

Monthly Tax Features is published by the Tax Foundation, Incorporated. Original material is not copyrighted and may be reproduced. Please credit Tax Foundation, Incorporated.

Chairman of the Board W. Bruce Thomas
Executive Vice President Robert C. Brown
Director of Research Elsie M. Walters
Director of Federal Tax Policy Douglas P. Bates
Editor William J. Wilson
Publications Manager Sarah C. Wise

Tax Foundation, Incorporated
1875 Connecticut Avenue, N.W.
Washington, D.C. 20009
(202) 328-4500

(SOCIAL SECURITY SPENDING, from page 1)

somewhat below the 16.7 cents share it took in 1970.

Social services and income maintenance ran close behind, ranking fourth at 13.1 cents of each spending dollar. (This included public welfare—both cash payments for living allowances and Medicaid benefits—health and hospitals, and unemployment insurance.) By comparison, 8.5 cents of each dollar went for these purposes in 1960, and 10.7 cents in 1970.

Interest on general debt comprised the next largest spending item, requiring 8.8 cents of each dollar. This compared with 6.2 cents in 1960, and 5.5 cents in 1970. (Among Federal expenditures only, such interest payments now rank as the third largest spending item.)

The five most expensive government functions—social security, national defense, education, social services and income maintenance, and interest on general debt—together claimed nearly 68 cents of every dollar of government spending in fiscal year 1981.

Government employee retirement, while a smaller part of the total than the items above, has shown a steady rise from 1.4 cents of each dollar spent in 1960 to 1.9 cents in 1970, and 3.0 cents in 1981.

The table on page 1 gives further details.

Budget = 17¢ Cuts Per \$1 Tax Hike

On June 23, the First Concurrent Budget Resolution for fiscal year 1984 passed both Houses of Congress. Actually, two versions of the Budget were contained in the resolution assembled by the conference committee and adopted by both the Senate and the House of Representatives. Tax Foundation analysts point out,

One version calls for total spending of \$849.5 billion, revenues of \$679.6 billion, and a deficit, assuming these targets are met, of \$169.9 billion. Under this budget, fiscal year 1984 spending will be \$42.1 billion higher than this year, and revenues will increase by \$75 billion, including projected new taxes.

But that's only half the story.

Another version of the Budget, preferred by the House but presented to and passed by the Senate, contains a "reserve fund" of \$8.5 billion. Budget authority and outlay targets in this version embrace several new initiatives in domestic programs that would be triggered only through the enactment of authorizing legislation.

(Continued on page 4)

Congressional Decisions in First Concurrent Budget Resolution for 1984

Fiscal Years 1984-1986
(Billions)

Item	1984	1985	1986	Total 1984-86
Budget totals				
Outlays	\$ 849.5	\$ 906.8	\$ 963.0	\$2,719.7
Revenues	679.6	750.5	835.8	2,265.9
Deficit	169.9	156.3	127.2	453.4
Reconciliation ^a				
Outlays	-2.8	-3.9	-5.5	-12.3
Revenues	12.0	15.0	46.0	73.0
Reserve fund	8.5	3.5	2.0	14.0
Debt limit (end of year)	1,614.6	1,830.1	2,022.8	N/A

^aInstructions by the full House and Senate to legislative committees to reduce current-law outlays or raise current-law revenues by the amounts indicated, in order to meet targeted budget totals.

Source: Conference Report, First Concurrent Resolution on the Budget—Fiscal Year 1984, June 21, 1983.

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"Bumper Car Tax Policy"

Remember trips as a youngster to the amusement park? Remember the bumper cars? Maybe it was the feeling of power, of being in the driver's seat. Maybe it was childish glee at being able to unleash hostility without fear of reprimand. Whatever their appeal, bumper cars featured prominently in our youth.

Sometimes the taxwriters here in Washington seem to have a bumper car mentality when it comes to raising revenues. Time was when this nation had a consistent, on-going approach to tax policy. Long-term consequences were weighed in any deliberations. Experience counted. Bipartisanship was the rule. As Representative Barber Conable, a past master of policymaking, put it, "The tent was big enough for everyone to get under."

In 1981, a carefully thought out tax act was framed and passed. Most of what it contained reflected years of thought and work, years of dialogue between legislators and analysts inside and outside government. Despite some flaws, the Economic Recovery Tax Act of 1981 (ERTA) was, on the whole, a well-crafted piece of tax legislation. It was the last of the breed.

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), by contrast, stands as the spawn of what I call bumper car tax policy. As the recession deepened, \$98 billion became the magic number. No serious thought was given to \$98 billion in spending reductions. Only "revenue enhancements" were considered. With eyes focused on the bottom line, tax writers charged after likely targets. Chalk some of it up to the headiness of power; some of it, to the glee of creating a

ruckus in the henhouse; some of it, to sheer partisanship.

In any event, TEFRA emerged as a policyless tax act, to coin an inelegant phrase. The lawmakers simply bounced off one revenue option after another until they hit the \$98 billion level.

The same hit-or-miss approach is now underway for 1984, although the magic number this year is \$12 billion, since there is so little left to take. As in 1982, there is the same lack of consistent policy, the same indifference to what makes an economy tick, the same distaste for the hard mental work that thoughtful tax legislation demands. Just the \$12 billion bottom line commands attention.

It's a shame. Bumper cars in the hands of little boys are harmless. Bumper car tax policy in the hands of election-bound lawmakers can cost taxpayers a lot of money.

"Time was when this nation had a consistent, on-going approach to tax policy."



(GOVERNMENT SPENDING, from page 1)

Federal, State, and Local Government Expenditures^a Selected Fiscal Years 1950-1983

Fiscal year	Amount (billions)			Total expenditures	
	All governments	Federal	State and local	Per household	Per capita
1950	\$ 70.3	\$ 44.8	\$ 25.5	\$ 1,614	\$ 466
1960	151.3	97.3	54.0	2,866	847
1965	205.7	130.1	75.6	3,581	1,067
1970	333.0	208.2	124.8	5,252	1,643
1975	560.1	340.5	219.6	7,875	2,612
1976	625.1	389.9	235.2	8,579	2,886
1977	680.3	430.6	249.7	9,176	3,111
1978	745.4	477.8	267.6	9,804	3,373
1979	832.4	535.7	296.7	10,764	3,726
1980	958.6	615.4	343.2	11,867	4,243
1981	1,109.8	717.4	392.4	13,474	4,859
1982 ^b	1,196.9	785.8	411.1	14,329	5,192
1983 ^b	1,300.3	864.8	435.5	15,345	5,587

^a Grants-in-aid are counted as expenditures of the first disbursing unit.^b Estimated by Tax Foundation.

Source: Basic data from U.S. Department of Commerce, Bureau of the Census; computations by Tax Foundation.

(BUDGET RESOLUTION, from page 3)

In other words, Congress has to explicitly decide to spend the money. However, Congress seems to be anticipating that it will do so.

While the widely publicized deficit number does not take into account this extra \$8.5 billion in spending, the public debt level adopted by both the Senate and House does include these outlays. When it comes to making Federal money flow, the debt limit is the controlling factor. The deficit number is irrelevant.

Setting aside the "reserve fund," both versions of the Budget contain binding directives to certain committees to enact legislation reducing spending levels that would automatically occur, absent congressional action. The total reductions called for are \$2.8 billion in fiscal year 1984, \$3.9 billion in 1985, and \$5.5 billion in 1986—a three-year total of \$12.3 billion. Note that these are reductions in the amounts of growth, not net reductions of spending from fiscal 1983.

Independent of these spending cuts is another directive to the tax-writing committees to raise revenues by \$12 billion in 1984, \$15 billion in 1985, and \$46 billion

New "Facts and Figures" Updates Fiscal Profile

Facts and Figures on Government Finance is Tax Foundation's widely used handbook of public finance data. The 22nd edition in a biennial series stretching back to 1941 is scheduled for fall publication. "Facts and Figures" offers a varied portrait of United States tax, fiscal, and economic life in some 283 tables, 38 of them brand new in this edition. Among the highlights are:

Industrial production rose by 37.6 percent between 1967 and 1982 for all manufacturing industries combined. Output of nondurables rose 56.2 percent; for durable manufacturing goods the rise was only 24.7 percent.

* * *

Taxes on goods and services contribute a smaller share of total tax revenues to governments in the United States (16.6 percent) than in any other major industrial nation except Japan (16.4 percent). On the other hand, property taxes in the United States provide a larger portion of tax revenues (10.04 percent) than in any other major country except the United Kingdom (12.09 percent).

* * *

Average yields of U.S. Treasury bills (new issues, 3-month) reached double-digit levels for the first time in 1979—10.041 percent; it was not until 1956 that yields were as high as 2 percent.

* * *

In the last thirty-three years (since 1950), U.S. production (Gross National Product in constant dollars) declined in seven years; productivity (output per person-hour) fell in three years (1974, 1979, and 1980); and consumer prices fell only once (four-tenths of 1 percent in 1955).

in 1986—\$73 billion in new taxes over three years.

By voting one budget resolution with two versions of the Budget, fiscal years 1984-86, Congress has enabled itself to promise 17 cents worth of spending cuts for every \$1 of tax hikes—unless it decides to wash out even this modest savings by spending the reserve fund.

"When it comes to making Federal money flow, the debt limit is the controlling factor."



TAX FOUNDATION, INCORPORATED

1875 Connecticut Avenue, N.W., Washington, D.C. 20009

Non-Profit Org.
U.S. Postage
PAID
Washington, D.C.
Permit No. 1287

FEDERAL TAX POLICY MEMO

JULY 1983
VOL. 7, NO. 2

Evolution of the Federal Tax System: 1954-1983

By William C. Penick

The last quarter of a century, roughly the mid-1950s to date, has been a period of most frequent and dramatic changes in the Federal tax system. Most observers of the Federal tax scene apply three, or possibly four, criteria for evaluating proposed tax legislation. These are:

- (1) Fairness or equity;
- (2) Simplicity or understandability to the average taxpayer;
- (3) Economic impact, including incentives or disincentives for savings, investment, and other types of economic behavior; and
- (4) Efficiency of the change—whether it will accomplish its objective without creating undue administrative or compliance problems.

EARLY HISTORY

While we had brief experience with Federal income taxes in the 19th century, the "modern" income tax system traces its roots to 1913. There were several revenue acts during the next four decades, but the 1954 Act was by far the most important attempt by Congress to put our income tax laws together in a cohesive and logical package. Whether they succeeded or not is obviously debatable.

Once the 1954 Act was in place and we had a chance to live with it for a few years, Congress commenced a program of both substantive change and fine tuning, largely directed toward concerns about fairness or equity, which was translated into identifying perceived loopholes and unintended benefits and trying to eliminate them. This led to a series of revenue acts commencing in 1962 and extending for nearly 15 years, culminating in the Tax Reform Act of 1976. The principal acts falling into this period were the Revenue Acts of 1962 and 1964, the Tax Reform Act of 1969, the Revenue Act of 1971, and the Tax Reform Act of 1976.

The **Revenue Act of 1962** was the most significant piece of tax legislation to follow the 1954 changes. Its stated purposes were to: stimulate economic growth in the United States; improve our competitive position abroad; raise our standard of living at home; and improve the "equity" of our tax structure.

To accomplish the first objective, the investment tax credit was introduced into the Code. To achieve the latter, travel and entertainment expenses were restricted; bad debt provisions for financial institutions were reduced; changes were made in the taxation of foreign operations, including the taxation of Americans working abroad; depreciation recapture was adopted for depreciable assets other than real estate; and changes were made to improve compliance.

A major change in the corporate and individual rate structure occurred in the **Revenue Act of 1964**. The range in individual tax rates during the latter stages of World War II

was 23% to 94%. The top rate came into play at \$200,000 for a joint return. There was an overall ceiling on the total tax burden of 90% for 1944 and 1945, and ranging from 77% to 88% during the Korean War.

A rate structure ranging from 20% to 91% was in effect until 1964 when it was reduced to 16% to 77%, and to 14% to 70% commencing in 1965. These rates remained in place until the 1981 Act, except for temporary surtaxes in the late 1960s. The top corporate rate was reduced from 52% to 50% in 1964, and to 48% in 1965.

The **Tax Reform Act of 1969** was intended to be a substantive and comprehensive reform of our income tax laws. To a considerable extent, it was motivated by disclosures that a number of individuals with high levels of adjusted gross income (\$200,000 or more) were paying little or no taxes.

The investment tax credit enacted seven years earlier was repealed. The increased tax revenues anticipated through repeal of the investment credit (over \$8 billion over three years) and other "reform" measures were more than offset by the reduction in the tax burdens of lower income groups. The tax reform objectives were achieved largely through imposition of the tax preference system, another blow for simplification. Tax relief for lower income groups was achieved primarily through small rate reductions and increases in the standard deduction and low-income allowance. In addition, a top rate of 50% on earned income was adopted.

The stated purposes of the **Revenue Act of 1971** were to provide a balanced program of tax reductions for individuals and tax incentives for business. Key members of Congress expressed concern about high unemployment, the impact of inflation on taxes, the need to modernize productive facilities, and our declining level of exports.

One of the major provisions in the 1971 Act was restoration of the investment tax credit under a new name, "Job Development Investment Credit." To stimulate exports, the DISC approach was adopted. Individual tax reductions were created by increases in personal exemptions and the standard deduction. A stated reason for the individual changes was to alleviate the impact of inflation, sometimes referred to as *Ad Hoc Indexation*, or *Political Indexation*.

The **Tax Reform Act of 1976**, over three years in the making, was intended to review the entire tax structure to eliminate perceived abuses and unintended benefits. Extensive hearings were held on tax shelter schemes, the treatment of foreign source income, the regulation of tax professionals, and many administrative provisions.

When completed, the Act contained such things as:

- ☐ Capitalization of construction period interest and taxes;
- ☐ Recapture of depreciation on real property;
- ☐ Strengthening the maximum tax on preferences;
- ☐ Restrictions on DISC (incremental approach); and

- ☐ Tougher rules on foreign tax credits for foreign oil and gas operations.

Another part of the 1976 Act was the elimination of many so-called deadwood provisions that had accumulated in the Internal Revenue Code over many years. Nearly 150 sections of the Code were repealed and major deletions were made in 850 others.

Following the 1976 Reform Act, Congress began to show more concern about economic issues and the impact of the tax system on savings and investment. The next two major pieces of legislation were the **Revenue Act of 1978** and the **Economic Recovery Tax Act (ERTA)** of 1981. Both of these tax bills made significant changes intended to encourage savings and investment, to recognize the impact of inflation on the tax system, and generally to stimulate the economy.

The centerpiece of the 1978 Act was the major reduction in capital gains taxes. Ironically, the capital gains changes originated from proposals made by the Carter Administration that would have increased the level of taxation. Congress quickly rebelled over this proposal, as well as a number of others recommended by the Administration, and the final product went in the other direction. From a theoretical top rate of nearly 50% on long-term gains, the maximum rate dropped to 28%.

Aside from the capital gains changes, individual tax reductions were accomplished through widening tax brackets and changes in the zero bracket amount, formerly called the standard deduction.

At the business level, the corporate tax rate was reduced from 48% to 46% with a graduated structure from 17% to 46% up to \$100,000 of taxable income. The investment tax credit was liberalized, and the rate (10%) made "permanent," and increased incentives were enacted for rehabilitating older structures. The minimum tax on tax preferences for individuals was changed by removing capital gains as a preference item and subjecting them to a new alternative minimum tax in place of the add-on scheme previously applicable.

ECONOMIC RECOVERY TAX ACT OF 1981 (ERTA)

From a conceptual viewpoint, ERTA was probably the most important piece of tax legislation we have seen in a quarter of a century. It was the first major tax bill under the Reagan Administration. It made dramatic changes in our system for cost recovery, investment incentives, overall tax rates, recognition of inflation, and estate and gift taxes. As its title suggests, its principal objectives were to create incentives for economic development and to reduce or eliminate disincentives for savings and investment.

The Act started with a fairly simple program proposed by the Administration that would have reduced individual taxes over a three-year period by roughly 30% and stimulated business investment through a new cost recovery system, essentially the so-called 10-5-3 approach.

With a Republican-controlled Senate and a Democratic-controlled House, however, consideration of the Administration proposals quickly evolved into a political bidding contest. The finished product went far beyond the initial proposals and, even though ultimately backed by the President, it probably went beyond what he and his top advisors really

wanted.

Among other things, ERTA:

- ☐ Reduced the top individual rate to 50% on all types of income and the entire rate structure by about 25% over three years;
- ☐ Indexed individual tax brackets commencing in 1985;
- ☐ Created a new cost recovery system (ACRS) for depreciating business assets;
- ☐ Permitted a tax credit for "incremental" research and development expenditures; and
- ☐ Provided major reduction in estate and gift taxes.

Even though its principal business provisions were slanted toward encouraging capital investment, business groups generally, both capital and labor intensive, rallied behind the program and actively supported it. This was caused in large part by the President's personal appeal to leading business groups, and broadly based support was generated.

TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982 (TEFRA)

The driving force behind the 1982 Act was concern over rising Federal deficits. This led to the reexamination of major portions of ERTA and a redirection of tax policy toward loophole closing and eliminating perceived abuses.

Essentially, TEFRA took back many of the benefits of ERTA. It provided the Internal Revenue Service a new arsenal of weapons to seek compliance with existing tax laws. It attempted to address abuses involving corporate mergers and acquisitions and employee retirement plans. Its dominant objective, however, was to generate tax revenues.

Among other things, TEFRA:

- ☐ Reduced medical and casualty loss deductions;
- ☐ Expanded the alternative minimum tax system;
- ☐ Reduced benefits from ACRS and the investment tax credit;
- ☐ Repealed safe harbor leasing;
- ☐ Tightened rules for completed contract method;
- ☐ Enacted changes in tax rules for mergers and acquisitions;
- ☐ Made major changes in pension programs;
- ☐ Reduced possessions' corporation benefits, primarily Puerto Rico;
- ☐ Increased taxes on certain life insurance companies; and
- ☐ Adopted several provisions intended to improve compliance with tax laws, including greater penalties for underpayment of tax, increased information reporting, withholding on payments of dividends and interest.

Contrary to strong business support for the 1981 Act, the development of TEFRA divided the business community. The net result was that most business groups were ineffective in opposing major changes that were adverse to their interests.

In the final analysis, the President again put his neck on the line and, through his personal persuasion, prevailed upon Congress to pass a package that I suspect he and many of his top advisors did not really like. However, the size of anticipated budget deficits led to the enactment of many provisions that are distasteful, to say the least, to major segments of the taxpaying population.

Finally, while the reductions under ERTA were divided roughly 80%-20% between individual and business taxpayer-

ers, increases under TEFRA went in the other direction. More than half of the benefits under ERTA for business were repealed by TEFRA.

GRADING 25 YEARS OF TAX LEGISLATION

We noted earlier the criteria that are usually applied to evaluate tax proposals. If we use them to grade the bills we have discussed earlier, either separately or collectively, and on a scale of 1 to 10, I would give Congress no better than a "6." Some bills were better than others, but none deserve very high marks. ERTA probably rates an "8."

With respect to "equity and fairness," assuming we can agree on what those terms really mean, some areas of abuse have been modified or eliminated over the last 25 years. For example, it is more difficult today to structure flimsy tax shelter arrangements, where a taxpayer can achieve huge writeoffs in excess of his real investment, with little or no economic substance. It is more difficult for taxpayers with large amounts of economic income to completely avoid taxes.

The improvements in making the system more equitable have been achieved largely at the expense of much greater complexity. Income averaging, the preference tax system, complex rules governing charitable contributions and many other items that we can think of have made the system incomprehensible to millions of taxpayers. The phenomenal growth in tax return preparation services over the last quarter century is a clear indication of the fact that most taxpayers simply cannot cope with our complex tax system.

In this regard, a great deal of the complexities that have been created stem from the almost fanatical compulsion of the tax writing committees and staffs to try to achieve perfection and to anticipate every conceivable way that a provision might be avoided.

With respect to economic impact, the system still contains some bias against savings and investment, although it was better after the 1981 Act than 25 years earlier. Adoption of the ACRS system in 1981 and more cautious changes made earlier with the ADR tax depreciation system recognized to some extent the impact of inflation on business investment. By permitting more rapid recovery of cost, the risk of erosion of investment caused by inflation is reduced. The expansion of tax deferred investment vehicles, such as HR-10 plans and IRAs, is providing significant incentives for savings.

In my view, the most important change in our income tax structure over the last 25 years is the reduction in tax rates. This started on a modest scale in 1964, was continued when the maximum tax on earned income system was adopted in 1969, and reached fruition in 1981 with the reduction in the top individual rate and the top estate tax rate to 50%.

I have always felt that the greatest cause of artificial tax planning schemes and abusive tax shelters is high individual tax rates. When an individual has significant amounts of income subject to Federal taxation at a 70% rate or higher, he is less concerned about the economics and substance of an investment since he is investing one of his dollars to two of the government's.

The 1982 Act, TEFRA, is obviously not my choice for the best tax bill of the century. With the possible exception of eliminating some abuses in the mergers and acquisition and retirement plan areas, I give TEFRA low marks by almost any

criteria. The dominant motive behind TEFRA was purely and simply dollars. The Congressional budget committees directed the tax committees to raise \$100 billion over three years, and that is precisely what they did, if you can believe the revenue estimates that attach to TEFRA's various provisions. I give TEFRA about a "3."

WHERE DO WE GO FROM HERE?

Debate on tax policy in the 98th Congress seems to be starting out on pretty much the same basis as 1982. Understandably, Congressional leaders are concerned about projected budget deficits in the \$200 billion range and up, not only for fiscal 1984 but stretching well into the future.

The deficit arises because projected spending (around \$850 billion for fiscal 1984) exceeds anticipated revenues (about \$650 billion). It does not take a genius to note that it can be reduced by (1) increasing revenues, (2) decreasing expenditures, or (3) a combination of these. To the extent the budget deficit is not reduced, the government must borrow and this puts further pressure on the available capital in this country, where the government is already taking an increasingly large share in competition with the private sector.

While none of us likes to see large government deficits, particularly continuing indefinitely into the future, some believe that, when the economy is still relatively weak even though showing some signs of recovery, it may be better to live with deficits than to impose additional taxes on a fragile economy. Our main concern now should be to encourage the economy to grow, and to encourage people to save, so that more capital will be available at a reasonable price.

Congress is obviously faced with a real dilemma, and it will have to balance conflicting demands in attempting to come up with a solution which is the least bad of several undesirable alternatives. The end result is likely to be another round of tinkering with the tax system, much like that in 1982.

Since different tax changes affect different groups in different ways, we see great tension between different sectors of our economy. Small business vs. large business, labor vs. capital intensive, companies involved in research and high technology, particular problems of service industries—these often create conflicting demands for changes in our tax system. The somewhat uniform business backing for the 1981 Act seems a thing of the past, and we are likely to see greater stress on the tax legislative process further into the 1980s.

CREDIBILITY OF REVENUE ESTIMATES

We have noted that the dominant factor behind the 1982 Act, and probably 1983, is raising revenues. This leads to the question of how revenue estimates from tax changes are determined. This has been a controversial factor in tax legislative deliberations for many years and needs to be reexamined.

Basically, when a tax change is proposed, the staffs of the Treasury Department, Joint Tax Committee and, in some cases, the Congressional Budget Office, develop estimates based on the number of taxpayers affected, the volume of economic activity that might be involved, assumptions as to inflation and the rate of growth in a particular economic sector, and other factors. This results in a dollar figure relating to the particular change. Generally, this approach assumes no change in taxpayer behavior if the tax laws are changed.

Common sense suggests this is seldom a valid assumption. Traditional revenue estimates also generally don't consider secondary or tertiary effects—so-called feedback. A couple of examples illustrate this point.

In 1978, when capital gain reduction was under consideration, Treasury officials estimated that reducing capital gains taxation would reduce tax revenues by approximately \$2 billion for 1979, the first full year of the reduction. Advocates of capital gain reduction argued that, if rates were reduced, the volume of transactions generating gains would increase, taxpayers locked into an investment would have greater incentive to liquidate their holdings and, on an overall basis, including additional commissions for securities dealers, tax revenues might increase. This is precisely what happened. Rather than a revenue loss for 1979 of \$2 billion, recent analyses show that tax revenues from capital gains transactions increased by nearly \$2 billion for 1979, and \$700 million for 1980.

Another recent example involves an estimate of the tax effect of eliminating the current deductibility of intangible drilling costs (IDC) for oil and gas wells. Joint Tax Committee staff estimates indicate a revenue gain while a Price Waterhouse study of this issue came up with the conclusion, with which I fully agree, that eliminating the intangible drilling cost expensing election would probably cause a revenue loss. Elimination of current expensing of IDC would probably decrease exploration and drilling activities which would cause cutbacks in sales of goods and services for items used in drilling. Earnings and taxes of drilling workers would be cut back, and businesses providing drilling services would have lower profits which, in turn, would reduce their taxes.

Revenue estimating is not an exact science, whether under the traditional static approach or considering feedback and other changes that might occur if tax changes are enacted. Since estimated revenue effects are given such importance by Congressional committees, however, I hope that a better method of estimating can be developed.

PROSPECTS FOR THE 1980s

There is more concern today about the complexity of the tax system than I have ever seen. The frequency of changes as well as their magnitude makes it almost impossible for even highly skilled tax professionals to keep current. This creates almost insurmountable problems for the Internal Revenue Service and Treasury Department who must interpret and administer these changes through regulations and rulings. The backlog of regulations projects is nearly 500, and the Chief Counsel's Office at the IRS is losing ground.

Congress is beginning to show interest in broad conceptual changes in the tax system, rather than continuing to tinker with the income tax rules. There is growing support for the proposition that our present income tax system, as the major source of Federal revenues, has outlived its usefulness. A broadly based income tax system, with a single rate (sometimes called a flat tax) or a smaller number of progressive rates, has generated a great deal of rhetoric and in time may receive serious consideration.

The Bradley-Gephardt approach, now called the "Fair Tax" system, has probably received more attention than other flat tax proposals. The Fair Tax bill would materially broaden the income tax base by eliminating most deductions and credits.

However, payments by individuals for home mortgage interest and taxes, charitable contributions, state income taxes, and contributions to IRAs and Keogh plans would continue to be deductible. A 14% tax rate would apply to this broadened tax base. A surtax of 12% would apply to adjusted gross income (AGI) in excess of \$25,000 (\$40,000 on joint returns), and 16% on AGI over \$37,500 (\$65,000 on joint returns).

Because of the structure of the tax, itemized deductions such as contributions, mortgage interest, and state income and property taxes would generate tax benefit only at the basic 14% rate.

Corporations would pay a flat rate of 30%, and many existing deductions, credits, and exemptions available to business entities would no longer be allowed.

The Bradley-Gephardt approach is cleverly constructed. By retaining deductions for homeowners' mortgage interest and taxes and charitable contributions, it tries to avoid the political land mines that other flat tax proposals are likely to encounter. Charitable institutions and real estate and construction groups are powerful adversaries against any tax proposals that would jeopardize their interests.

The alternative of moving toward a consumption tax will have to be explored seriously before this decade is over. With anticipated continuing high deficits and the need for a broader and more stable tax base, a consumption tax has a lot of appeal. The two types being discussed most frequently are (1) a transactional tax like a value-added or national sales tax and (2) an annual determination of total consumption, to be taxed under a graduated rate structure. This latter approach was suggested by the Ford Administration Treasury team in its "Blueprints for Basic Tax Reform," issued over six years ago.

The major political factors arguing against Federal consumption taxes generally relate to the redistribution of tax burden among taxpayer groups and shifting toward a more regressive tax system. These problems can be answered to some extent by the way the tax is structured, but there remains a strong perception of regressivity about any consumption tax. This will create significant political problems whenever such an approach is seriously proposed.

We have tinkered with the income tax system long enough and have tried to use it to accomplish objectives that it cannot solve effectively. It is time for a change. With all of the traumatic problems we are likely to have in switching to a new type of tax structure, whether consumption-oriented, fair tax, or flat tax, I firmly believe that is the direction tax policy should take in the next decade.

About the Author

WILLIAM C. PENICK recently retired as Senior Partner-Legislative Tax Policy for Arthur Andersen & Co., in Washington, D.C. Mr. Penick serves on the Board of The Tax Council and is a member of Tax Foundation's Tax Advisory Group. He has been involved in tax policy matters with the American Council for Capital Formation, the American Enterprise Institute, and the American Institute of Certified Public Accountants.

This paper is adapted from remarks presented by Mr. Penick before the Golden Gate University, Tax Luncheon Series, in May 1983. The views expressed are those of the author and do not necessarily reflect those of the Tax Foundation.

TAX·FEATURES

Local Government Revenues Triple Over Ten-Year Period

General revenue of local governments topped \$257 billion in fiscal 1981 (the latest year reported), nearly three times the 1971 level of \$92 billion. From 1980 to 1981 alone, local general revenues rose by \$24.7 billion, or 10.6 percent.

Intergovernmental aid to localities totaled \$111 billion in 1981, with Federal and state funds combined accounting for a 43 percent share of local revenue for that year and 47 percent of the growth in local revenue for the decade. Direct Federal aid rose from just over \$3 billion in 1971 to more than \$22 billion in 1981—up 561 percent. State aid increased from \$31 billion to \$89 billion, or 186 percent.

Property taxes remain the largest segment of locally collected revenue, rising from \$37 billion in 1971 to \$72 billion in 1981. This 96 percent increase, however, was the smallest rate of growth recorded for any major revenue source. As a result, the relative share of local general revenue derived from property taxes slid from 40 cents per dollar of revenue in 1971 to 28 cents in 1981. (As a share of locally collected taxes, the property tax fell from 85 percent of the total in 1971 to 76 percent in 1981.)

Local sales and gross receipts taxes showed almost a fourfold increase for the decade, but still accounted for only a small share of total local general revenue—about 5 cents per dollar in 1981. The rise was greatest for general sales levies, which rose from \$2.3 billion in 1971 to \$9.2 billion in 1981.

Other local taxes, including income taxes and licenses, accounted for less than 4 cents per dollar of general revenue in 1981, up only slightly as a share for the decade.

In 1981, local governments raised nearly \$51 billion (almost 20 percent of total general revenue) through charges for public services and other nontax receipts.

(Continued on page 2)

We Are Moving!

Effective August 30, 1983, our new address is:

Tax Foundation, Incorporated
One Thomas Circle, N.W.
Suite 500
Washington, D.C. 20005
Telephone: (202) 328-4500

State and Local Taxes May Top \$300 Billion In 1983 Calendar Year

State and local general tax collections will probably exceed \$300 billion in the 1983 calendar year, for the first time in history, according to Tax Foundation analysts. This would follow in short order the passing of the \$200 billion mark in 1979.

For the years 1977-1982, state-local taxes rose by amounts averaging 8.4 percent annually, even with persistent recessionary conditions in the private economy. The cumulative 5-year increase was 50 percent—56 percent for states and 42 percent for localities.

Growth has been especially rapid for the more "broadly based" taxes. State and local units collected \$52.7 billion in individual income taxes in 1982, 71 percent more than five years earlier.

General sales and gross receipts tax collections, at \$61.9 billion in 1982, rose by 60 percent for the 1977-1982 period. One-fourth of the total dollar increases in general state-local taxes during these five years was attributable to general sales.

General tax collections of local governments passed the \$100 billion mark in 1982, owing primarily to a sudden resurgence in property tax growth. In an unexpectedly high rebound from the "Prop 13"

(Continued on page 2)

THIS ISSUE:

PAGE 1:
**Local Revenues
State/Local Taxes**
PAGE 2:
Medicare
PAGE 3:
Social Security
PAGE 4:
Facts & Figures

Composition and Growth of Local Government Revenue by Source Fiscal Years 1971 and 1981

Source	Amount (billions)		Percent of total		Percent change
	1971	1981	1971	1981	
Total general revenue, all sources ^a	\$92.0	\$257.2	100.0	100.0	179.7
Total, own sources	57.5	145.7	62.5	56.7	153.5
Total, taxes	43.4	94.8	47.2	36.9	118.2
Property tax	36.7	72.0	39.9	28.0	96.1
Sales and gross receipts	3.7	13.2	4.0	5.1	261.0
Other taxes and licenses	3.0	9.5	3.3	3.7	213.1
Current charges	9.8	31.5	10.7	12.2	221.4
Miscellaneous revenues	4.2	19.5	4.6	7.6	364.3
Total, intergovernmental aid	34.5	111.4	37.5	43.3	223.3
From states	31.1	89.0	33.8	34.6	186.4
From Federal	3.4	22.4	3.7	8.7	561.4

^aGeneral revenue is exclusive of utility, liquor store, and insurance trust revenue.
Source: Department of Commerce, Bureau of the Census; and Tax Foundation computations.

"About 29 million people are now covered by Medicare at a total cost of \$60.2 billion in calendar year 1983."

Burgeoning Medicare Costs Place Funding In Jeopardy By 1991

Congress may have bailed out the retirement and disability part of the Social Security system for the coming generation. But Medicare will soon need the same treatment, according to Tax Foundation analysis of the 1983 reports of the Boards of Trustees that oversee the Medicare program.

About 29 million people are now covered by Medicare at a total cost of \$60.2 billion in calendar year 1983. One program is Hospital Insurance (HI), which pays for inpatient hospital care of those aged 65 or over, and is funded by payroll taxes funneled through the Hospital Insurance Trust Fund. The other program is Supplementary Medical Insurance (SMI), which pays doctors' fees, outpatient hospital service, and other medical expenses for those 65 or older, and is funded chiefly by general revenues (75 percent in 1983), with remaining costs covered through premiums paid by users of the program.

Income to the trust funds will total \$64.3 billion in calendar year 1983, according to Tax Foundation economists. This luxury of income in excess of outgo will be short-lived, however. Current actuarial projections reveal that large deficits will begin to occur in the Health Insurance Trust Fund in the latter part of the 1980s and that the fund will be completely exhausted in either 1990 or 1991. Presumably, since doctors' bills, outpatient services, and medicine are funded largely through general revenues, money for the SMI will be raised by Federal (non payroll) taxes or borrowing.

(LOCAL REVENUES, from page 1)

This compares with \$14 billion in 1971 (representing an increase of 262 percent), and \$44 billion in 1980 (a one-year leap of almost 17 percent).

Interest earnings on local units' cash and security holdings—a significant share of the "miscellaneous revenue" total, amounted to \$10.7 billion in 1981, up from \$1.8 billion in 1971 and \$8.2 billion in 1980.

Although recent increases in local revenues have been sizable, growth in the last half of the decade did not measure up to that experienced during the first. Growth during the 1971-81 span showed a moderate deceleration, from an increase of 77 percent for the period 1971-76 to one of 58 percent for the period 1976-81.

The table on page 1 offers further details.

Monthly Tax Features

Monthly Tax Features is published by the Tax Foundation, Incorporated. Original material is not copyrighted and may be reproduced. Please credit Tax Foundation, Incorporated.

Chairman of the Board W. Bruce Thomas
Executive Vice President Robert C. Brown
Director of Research Elsie M. Watters
Director of Federal Tax Policy Douglas P. Bates
Editor William J. Wilson
Publications Manager Sarah G. Wise

Tax Foundation, Incorporated
One Thomas Circle, N.W.
Washington, D.C. 20005
(202) 328-4500

supplemented by increases in users' premiums.

Unfortunately, the problems of the early 1990s will not be the bottom of the cliff, but only its edge. On the average, if income is to match outgo in the HI Trust Fund between 1983 and 2005, payroll taxes must be increased by over 40 percent or benefit growth must be restrained by about 30 percent, according to current projections.

Foundation economists see even larger problems looming 75 years down the road. According to the actuarial projections through 2055, the HI program alone will explode to 3½ times its 1983 size in relation to taxable wages. This year HI spending will amount to 2.77 percent of wages and salaries subject to payroll taxes. By 2055, such outlays will grow to 9.37 percent of covered payroll. And this figure assumes that, after 2005, health care costs per unit of service will increase only at the same rate as average wages.

In recent years, this has not been the case. The rise in health costs outpaced wage increases by nearly 16 percent during 1973-74; they are now exceeding annual wage increases by 9 percent and are projected to rise about 2 percent faster than wages in 2005.

MARK YOUR CALENDAR

Tax Foundation's 35th National Conference and 46th Annual Dinner will be held this year on Wednesday, November 30, 1983, at the Plaza Hotel in New York City. The title of the Conference is "Taxes, Spending and Growth—Seeking a Balance." Complete details and reservation forms for the Conference and Dinner are in the mail.

(STATE/LOCAL TAXES, from page 1)

slowdown of the late 1970s, property taxes jumped by \$10.5 billion between 1981 and 1982, accounting for better than half of the year's net increase of \$19.6 billion in general state-local collections.

Also noteworthy, 1982 hallmarks the first time in 12 years that property taxes increased as a proportionate share of general state-local tax revenue—from 30.0 to 31.7 percent.

The table below offers details on state-local taxes for the years 1977-1982.

State and Local Taxes By Level of Government and by Type^a Years 1977 and 1982^b (Millions)

Level of government and type	1977	1982
Total	\$182,772	\$273,930
State	106,111	165,116
Local	76,661	108,814
Individual income	30,852	52,742
Corporation net income	9,709	13,494
Property	64,164	86,811
General sales and gross receipts	38,740	61,910
Motor fuel sales	9,365	10,597
Tobacco product sales	3,684	4,210
Alcoholic beverage sales	2,309	2,909
Motor vehicle and operators' licenses	4,961	6,712
All other	18,988	34,545

^aGeneral taxes only; excludes unemployment payroll levies that totaled \$17.617 million in fiscal year 1981 (latest reported).

^bTwelve-month periods ending in December of years indicated, based on quarterly reports.

Source: Department of Commerce, Bureau of the Census.

"1982 hallmarks the first time in 12 years that property taxes increased as a proportionate share of general state-local tax revenue."

Social Security Reform No Panacea

Congressional action on the Social Security system this spring, welcome though it is, falls far short of solving the problem of overall Federal deficits in the foreseeable future, Tax Foundation economists say.

In the past five years, deficits in the Old-Age, Survivors, Disability, and Health Insurance (OASDHI) program have totaled \$60.4 billion, accounting for about 11 percent of accumulated Federal deficits for the period. In all other programs combined—budget and off-budget—deficits have totaled \$485.2 billion or 89 percent of the combined total of \$545.6 billion for the years 1979-1983.

The annual report of the Board of Trustees of the OASDHI Trust Funds, released in June, projects that balances in retirement, survivors, and disability funds

(Continued on page 4)

Federal Deficits and OASDHI Transactions

Fiscal years 1979-1983

(Dollar Amounts in Billions)

Fiscal year	Federal deficit ^a	OASDHI deficit	Deficit excluding OASDHI funds ^a	
			Amount	Percent of total
1979	\$- 40.2	\$- 6.5	\$- 33.7	83.8
1980	- 73.8	- 6.4	- 67.4	91.3
1981	- 78.9	- 8.3	- 70.6	89.4
1982	- 127.9	- 13.1	- 114.8	89.8
1983	- 224.8 ^b	- 26.1	- 198.7	88.4
Total, 1979-1983	\$- 545.6	\$- 60.4	\$- 485.2	88.9

^aBudget and off-budget.

^bRevised to \$-226.0 billion in Mid-Session Review of the 1984 Budget. Source: Office of Management and Budget and Tax Foundation computations.

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"Why a Balanced Budget Eludes Us"

TQ. When is a ceiling not a ceiling?
A. When it's a floor.

That, in a nutshell, is why a balanced Federal budget has eluded those formulating the nation's tax and fiscal policy. When the Congressional Budget and Impoundment Control Act of 1974 was passed, the spending levels built into the first and second concurrent resolutions were intended as ceilings. Congressional appropriation committees were to spend no more than the dollar amounts specified.

With their penchant for wooing constituents with goodies, the ceilings quickly became floors. Congressional big spenders (often with the acquiescence or overt encouragement of Executive Branch agencies) made sure they spent no less than specified in the Budget—and then some.

The upshot has been a relentless escalation in Federal outlays for domestic social welfare programs and an equally relentless growth in Federal deficits.

Another reason why budget balance would elude us, even if we had all the tax revenues in hand to pay off the national debt, is that Washington would quickly find justification for new spending. There is an endless number of worthwhile programs. Strong arguments can be made in the name of compassion and human decency to justify virtually any kind of "people" oriented outlays. Until we realize that, just because a program is a worthy idea, it is not automatically obligatory for the taxpayers to foot the bill, a balanced budget will remain beyond our reach.

As has been observed before in this column, politicians find it easy to give away money.

With the 1984 elections waiting in the wings, it is highly unlikely that we will see any cuts in domestic spending.

How can spending be restrained? One partial solution might be found in opening up the budget process.

Under the present scheme, those from the private sector who are interested in holding down spending have no significant input until the presidential documents are in print. Why not include input from the private sector, informal consultation from analysts outside government, and even formal hearings? This could take place both as the Budget is being developed by the agencies under the supervision of the Office of Management and Budget, and while the Budget Committees of the Congress—and the appropriation committees, as well—are formulating their responses. We prepare regulations this way. Why not budgets and spending proposals?

If the spenders had to conduct their giveaways in the open, a little daylight might go a long way toward holding them in check.

"With the 1984 elections waiting in the wings, it is highly unlikely that we will see any cuts in domestic spending."

"AND EVERYWHERE THAT MARY WENT..."



TAX FOUNDATION, INCORPORATED

Varied Portrait of U.S. Economy Emerges in New "Facts & Figures"

Facts and Figures on Government Finance, Tax Foundation's widely used handbook on public finance, is scheduled for publication this fall. This biennial volume offers a comprehensive view of taxes; government spending; borrowing; government programs and services; Federal, state, and local tax rates; and social insurance, along with many relevant economic indicators. The 283 tables contained in this 22nd edition include 38 brand new tabulations. Among the highlights are:

"Governments in the United States ran a record deficit of \$117.4 billion in calendar year 1982."

Governments in the United States ran a record deficit of \$117.4 billion in calendar year 1982, topping the previous peak red-ink year of 1975, when they spent \$63.8 billion more than they received in revenues.

The Federal deficit amounted to \$149.5 billion in calendar year 1982. It was partly offset by a \$32.1 billion surplus in state-local operations that resulted from a buildup of balances in social insurance accounts, largely pension funds.

On general accounts, states and localities ran a \$4.1 billion deficit in 1982, up from \$75 million the previous year. Deficits as such do not show up in most official state-local budgets, however, because of budgeting methods that provide separate accounting for current and capital spending.

There were 82,688 government units in the United States in 1982, about 72,000 fewer than forty years earlier. The decline reflected the consolidation of school districts, from 108,579 in 1942 to 15,032 today. Trending in the opposite direction were special districts, a form of local government, which accounted for 28,733 of all units in 1982. Over 20,000 such jurisdictions have been created since 1942, nearly 5,000 of them in the past ten years alone.

"Taxes paid to all governments in the United States in 1982 were more than four times the 1967 amount."

The Tax Foundation's Tax Index, measuring trends in taxes at all levels based on 1967 as 100, moved up in 1982 for the 24th consecutive year, reaching 413.9. That is to say, taxes paid to all governments in the United States in 1982 were more than four times the 1967 amount. The U.S. output index in 1982, as measured by Gross National Product, stood at 382.6 percent of its 1967 level.

In 1982, the capacity utilization rate in manufacturing was 69.8 percent—the lowest on record in data going back to 1948. The previous low (72.9 percent) occurred in 1975.

Taxes of U.S. governments amounted to 30.72 percent of Gross Domestic Product (GDP) in 1980. U.S. taxes claimed a smaller share of output than taxes in the United Kingdom (36.14 percent) and in Germany (37.37 percent), but look a larger share than in Japan (26.06 percent). The highest relative tax levels for 1980 were in Sweden (49.63 percent of GDP and \$7,382 per capita), followed by Norway (47.31 percent of GDP and \$6,645 per capita). U.S. taxes per capita in 1980 were \$3,408.

State and local governments held \$454.4 billion in cash and securities at the end of fiscal year 1981. Slightly more than half was held for insurance trust systems—largely employee retirement funds.

In fiscal year 1982, nearly half of all funds raised in U.S. credit markets were raised under Federal government auspices. Most of the \$199.7 billion credit garnered by the Federal government was through borrowing from the public. There have been significant variations in the Federal participation rate over the past decade, with swings from 12.9 percent of the total in 1974 to 40.4 percent in 1976, to 18.9 percent in 1979 and 48.9 percent in 1982.

Wisconsin was the first state in the continental United States to levy both individual and corporate income taxes; it imposed both in 1911. (Hawaii introduced both income taxes in 1901.) Mississippi levied the first state general sales tax in 1932; it was quickly followed by 23 other states during the 1930s. New York State imposed an individual income tax in 1919, but did not levy a general sales tax until 1965.

In 1981, voters rejected 42 percent of the \$8.8 billion in proposed new municipal bond issues, approving issues valued at \$5.0 billion. Since 1947, the peak year of taxpayer opposition to new bond offerings occurred in 1975, when voters turned down 71 percent of the value of proposed issues.

Consumption Tax Study Available

"Consumption Tax: An Idea Whose Time is Coming" is a special report from the Tax Foundation which examines the consumption-based income tax, one possible solution to the problems which the present Federal tax system is encountering.

The new study examines the history of the idea, its current chances of success in Washington's political climate, and shows how such a tax would work by means of a sample "consumption tax annual return."

Copies are available from the Tax Foundation for \$5, plus \$1 postage and handling.

(SOCIAL SECURITY, from page 3)

will rise from \$24.8 billion on December 31, 1982, to between \$39.7 billion and \$45.3 billion by the end of December 1987. (Financing problems in the Hospital Insurance program are discussed elsewhere in this issue.)

According to the Administration's Mid-Session Review of the 1984 budget, issued in late July, Federal deficits under current laws are estimated at \$226.0 billion in 1983 and \$217.4 billion in 1984, rising to \$244.1 billion in fiscal year 1987, for a total of more than \$1.1 trillion over the five years.

The table on page 3 shows the impact of OASDHI costs on Federal deficits.